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Subject: RIN 3245-ZA02 VC-Owned Ventures in the SBIR program

VC-Owned Ventures should not b allowed to enter SBIR Competition

Allowing currently ineligible VC-owned businesses to enter the SBIR program will ultimately destroy the SBIR/STTR program.

The Situation

VCs claim they are being denied participation in the SBIR program. This is not true. Small businesses in which VC's are **minority owners** ("VC-backed") have been eligible since the beginning of the program. Small businesses that are majority-owned and controlled by VCs ("VC-owned") were, until January 2005, ineligible to participate. Since then, they are also eligible if the parent VC organization is itself eligible. *These ventures are controlled by well-funded financial entities, fully capable of addressing their own capital needs – and are able to compete for the 97.5% of the federal extra-mural R&D budget that is not reserved for the SBIR program.* The SBIR program is best served by funding small high tech ventures that do not have access to venture capital at the time of technology development. That meets the public-needs test that should be applied.

The justification offered for the change was that VC investment is crucial to startups in the biotech industry and that SBIR funds are needed to reduce the private risk of these investments. If that is the case, accomplish that goal with tax incentives for the VCs. Let them risk their own funds, not shift the risk to the federal government. I am opposed to any proposal that would allow a VC owned ventures to participate in the SBIR Program . VC firms either are multi-million entities funded by wealthy investors or established by large corporate interests. Allowing VC subsidiaries to receive SBIR awards could result in SBIR funds subsidizing research projects of wealthy entities rather than support small business entities which was the intent of the legislation. Do not let this camel get its nose in the tent.

Background

In the early 1980s, there was a growing national awareness that the small businesses were the primary engine of technological innovation and new job creation i.e. not corporations, university labs or venture capitalists. Yet, this vital sector of the economy was severely limited in accessing federal R&D funds, primarily because of the lack of resources required to compete against large, well-financed organizations. In 1982, Congress addressed this issue by authorizing the SBIR program. The program required that a small percentage of the federal extra-mural R&D budget be set-aside for exclusive access by the nation's most innovative small businesses. This leveling of the playing field allowed small businesses with limited resources to compete only with their similarly under-funded peers. In 23 years, the SBIR program has well-served the national interest, enabling the small business sector to develop many important and significant new technologies, and creating new jobs and improving national competitiveness. When a program works well, do not screw it up by letting VC-owned companies in the program. The program is not broke, do not fix it.

Issues
Some VC-owned businesses, encouraged by lax eligibility rule enforcement, began to participate in the SBIR program. When this growing practice became apparent in 2003, the SBA Office of Technology notified the participating federal agencies of these violations. As a result, SBIR funding to the ineligible SBIR applicants was terminated, many in the biotech field. In response, the VC and biotech industry lobbies are pressuring Congress to pass legislation allowing VC-owned small businesses to become SBIR eligible (falsely stated as "reinstated"). These special interests have advanced the argument that since VC-owned ventures have *(illegitimately)* participated in the SBIR in the past, no harm will result by now legitimizing this practice. This is BS. It is unfair competition, and was a corruption of the competition, as it did not meet the needs test or small business test. VC-owned applicants will have an unfair advantage over other applicants drastically changing the composition of SBIR participants, and will further unbalance the national SBIR portfolio. This will likely shift the SBIR portfolio to lower risk, higher ROI, faster-to-market technologies that VC firms desire. In the name of commercialization, venture capital objectives will overshadow technology priorities.

Allowing VC-owned ventures into the SBIR program will result in a damaging outcome for small businesses, especially in rural states having little or no VC investment activity. VC is primarily concentrated in ten states, that same ten states that tend to dominate in the SBIR program. This rule change will likely cause the SBIR program to be further concentrated in the 10 states that have a robust VC industry to the detriment or scientist, engineers and entrepreneurs in the other 40 states, esp. the 25 rural states. The FAST and Rural Outreach Program has helped level this playing field, and many rural states have seen significant gains in their small high tech ventures access the SBIR program. More resources are needed for the FAST and ROP program. It is in the national interest to spread technology and innovation across the country, not concentrate it in a few urban states already rich in resources. SBIR ventures that do not have VC backing have proven to develop great technology, and many have been able to attract VC during the commercialization process. In this way the entrepreneur's equity was preserved in this process, not enhancing the VC value in the portfolio through VC owned ventures. SBIR grants to VC owned firms is shifting their investment to the federal government and preserving their assets. That is not the purpose of the SBIR program.

Also large SBIR awards in DOD and HHS are hurting the program, but is very attractive to VC companies. When a $5 million Phase II award is made, six small businesses are denied the opportunity for a $750,000 Phase II award. This practice crowds out those legitimate small businesses who can't compete with VCs able to invest bucho bucks assembling world-class teams to propose large scale projects (the 97.5% non-SBIR component of the extra-mural R&D budget is the appropriate federal funding source for such projects). The SBIR program was created to prevent this gross mismatch of resources. If VC-owned ventures are allowed to enter the SBIR competition, the level playing field the original SBIR legislation created would once again be tipped in favor of the already rich and wealthy corporations and VC funds with a great detriment to innovation, technology and entrepreneurship, especially in the 40 states that do not have a robust VC industry.

Another specious argument that has been advanced by the VC & biotech advocates is that VC-owned companies are more likely than their under-financed small business competitors to carry their innovations into commercialization. This argument sidesteps the vitally important purpose of the SBIR program to create a level playing field so that underfunded small businesses would compete exclusively with each other to develop their innovative concepts. And that concept worked well for 23 years. The results are there and confirmed in several GAO reports. Being denied access to the SBIR program does not inhibit VC-owned businesses from using their own, or other, capital resources to commercialize their innovations, but diverting SBIR funds to VC-owned ventures does reduce the availability of funding to small high tech Ventures not owned by VC firms.

Conclusion

Please do not amend the Size Standards Affiliate rules to exempt ineligible VC-owned businesses, If the principles of fairness and equity governing the SBIR program are abandoned, the program will likely become another corporate and VC welfare program with SBIR administrators assuming that VCs are smarter than entrepreneurs and innovators. It would destroy the SBIR program that has worked so well for 23 years.

“IT AIN’T BROKE – DON’T FIX IT”

I urge the SBA, the federal SBIR agencies and the Congress to defend and maintain the integrity of the SBIR program, thereby enabling the nation’s individually-owned, under-funded small businesses to continue in their critical role of technology innovation and job creation.If the system ain't broke, don't fix it.

The Center for Innovation operates the SBIR outreach program for North Dakota, and works with scores of small high tech ventures to compete in the SBIR program. Our SBIR companies have a solid record of commercializing the results of their research without being VC owned, or even VC backed at the early states of technology development. We have helped launch more than 400 ventures, operate two tech incubators on the University of North Dakota campus, and work closely with angel, seed and venture capitalists to fund emerging ventures.

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